Preventative medicine

13/12/2022

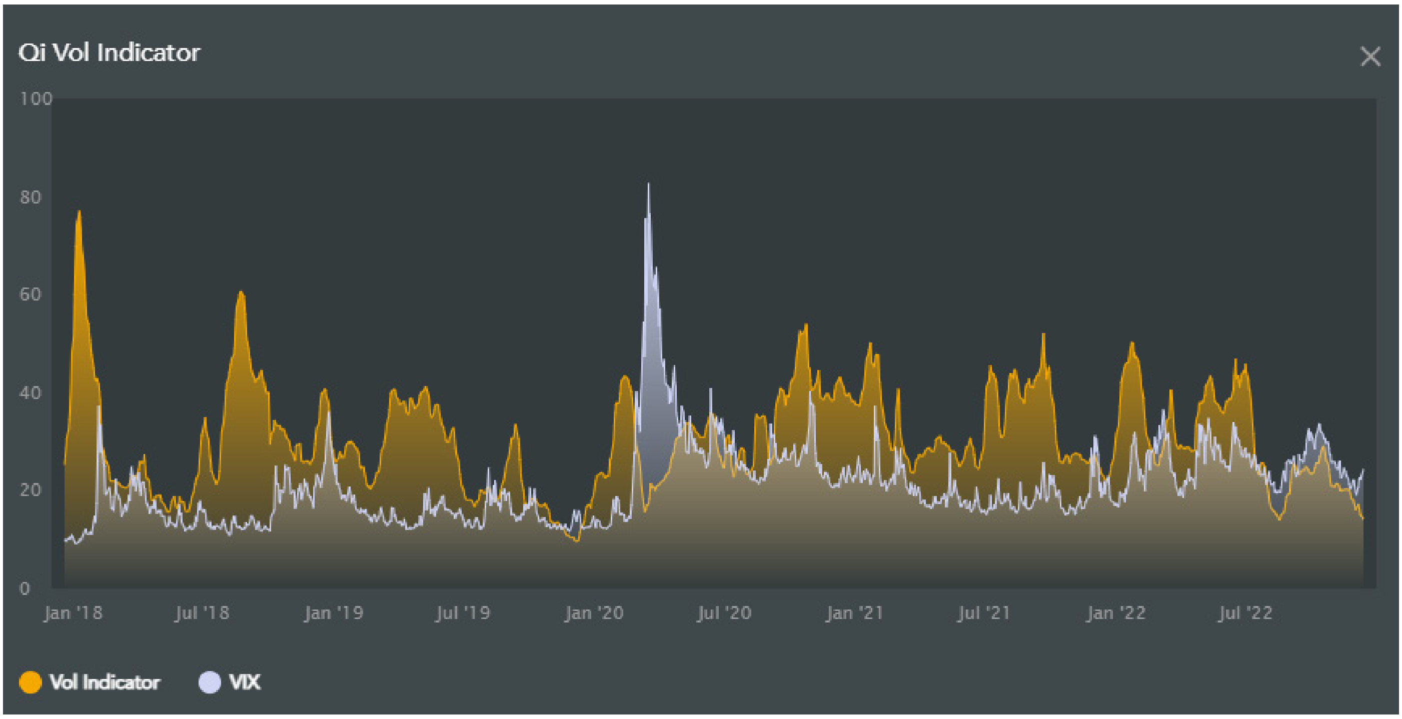
2022 has been all about macro.

Before we close the book on this year and start thinking about 2023, twelve reminders - one from each month - of how the Qi framework has helped augment the traditional, bottom-up approach to equity investing.

The topics in the last two - for November and December - could become the dominant themes for investors in 2023.

January – an early warning

Qi's Vol Indicator often leads spikes in VIX and we saw that again at the start of 2022. Investors were given an early heads up that macro conditions were shifting and markets should brace for higher volatility.



February – More downside for speculative tech

Unprofitable tech names were the first mover in this bear market but, by Feb, had stopped falling and were attempting to consolidate.

Not on Qi.

Model value kept trending lower thereby opening up a significant rich valuation on a host of spec tech plays - FINX, CLOU, FDN, GNOM, BBH & IGV (chart).

Original Qi insight - **More downside for spec tech?**

March – catch up

In mid-March, on Qi's models SPY screened as 5% cheap and QQQ was 11% below where it 'should' have been. Both represented significant valuation gaps and a flag that US equity indices had sold off too aggressively relative to macro conditions.

Qi model value for QQQ rose throughout March peaking on the 29th by which time the valuation gap had narrowed from -11% to just -1%. Thereafter model value resumed its downtrend.

Original Qi insight - **Catch up**

April – Brazil

Structurally bullish, tactically wary was the headline in our Apr 6th observation. The iShares ETF tracking Brazil EWZ was 15% rich on our models.

Even as a country set to benefit from the impact of Russia/Ukraine's conflict on commodity markets, the machine was telling asset allocators a lot of good news was priced.

Over the next month EWZ fell almost 21%.

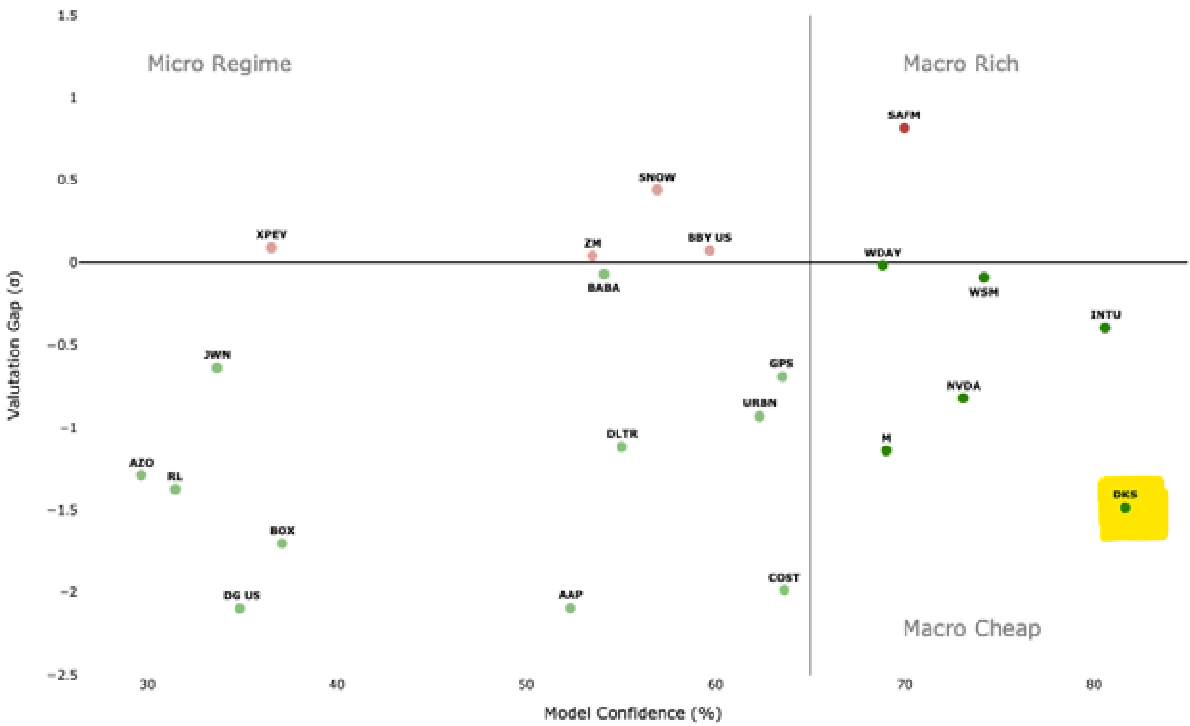
Original Qi insight - Structurally bullish, tactically wary

May – Bottom up meets top down: Dick's Sporting Goods

May 23rd and earnings season. Walmart and Target have already spooked markets with anecdotal evidence about inflation eating away at margins. Several US Retailers re due to report.

Qi flags that Dicks Sporting Goods is 25% cheap to model. Yes this week is about company fundamentals but a quick macro overlay identifies DKS as having discounted a lot of bad news already. Over the next three weeks it rallies 13.3%

Original Qi insight - **Bottom Up meets Top Down: US Retailers**



June – SPY vs. GOVT

On June 16th, Qi showed the S&P500 was at an extreme level relative to bonds. This was on top of an uptick in Qi model value for SPX. We surmised that macro conditions were improving at the margin, that SPY was cheap to GOVT and that quarter and half year-end re-balancing flows were imminent.

Over the next 8 weeks SPX rallied over 17% and equities outperformed bonds.

Original Qi insight - **SPY vs. GOVT**

July – Value vs. Growth & the power of macro

Low bond yields fuelled the bull market in Tech & Growth plays. So says the common wisdom. Like most truisms there is a fair degree of truth in it. But is it just about rates? What about other macro drivers?

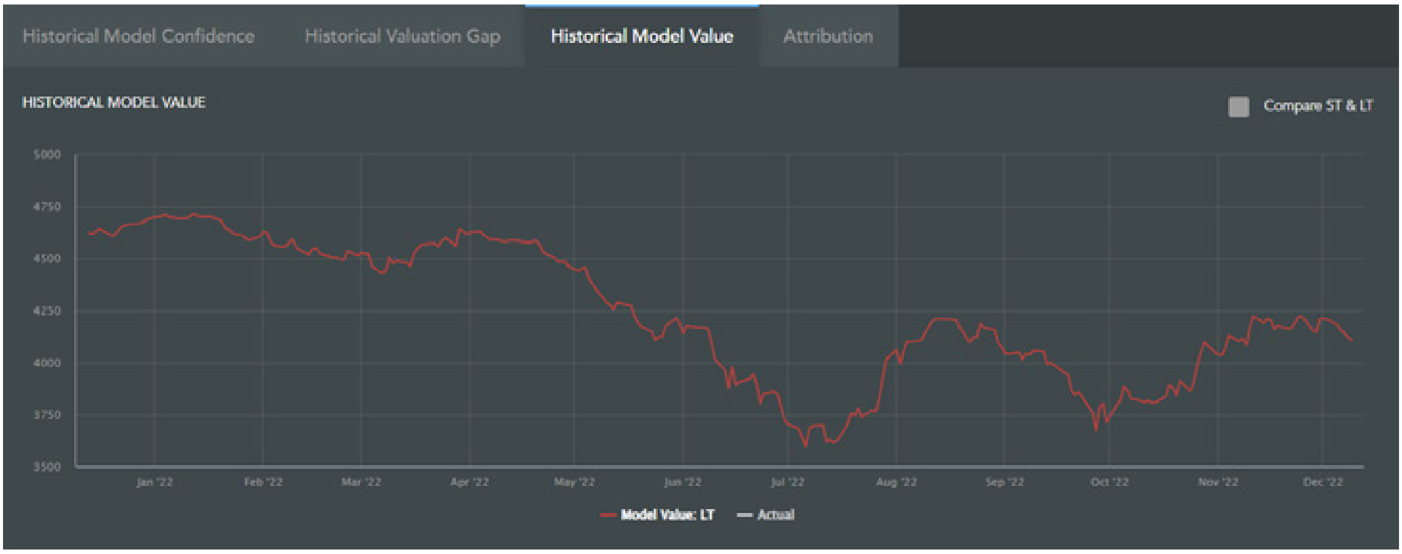
Factor leadership changes, regimes shift, only a machine can capture the underlying patterns in real time. A nice example of how even when an equity investor thinks they're using a factor-based approach, they're actually running macro risk.

Original Qi insight - **Proof! What Value needs to outperform Growth**

August – measuring macro in one chart

The red line shows Qi model confidence for the S&P500. In bottomed and turned higher early in July, highlighting that the macro environment was ripe for a bear market squeeze.

It peaked early in August. Jackson Hole and Powell's hawkish speech was still three weeks away but the machine was already recognising that financial conditions were shifting under the surface, getting nervous that the Fed Chair would double down on the fight against inflation.



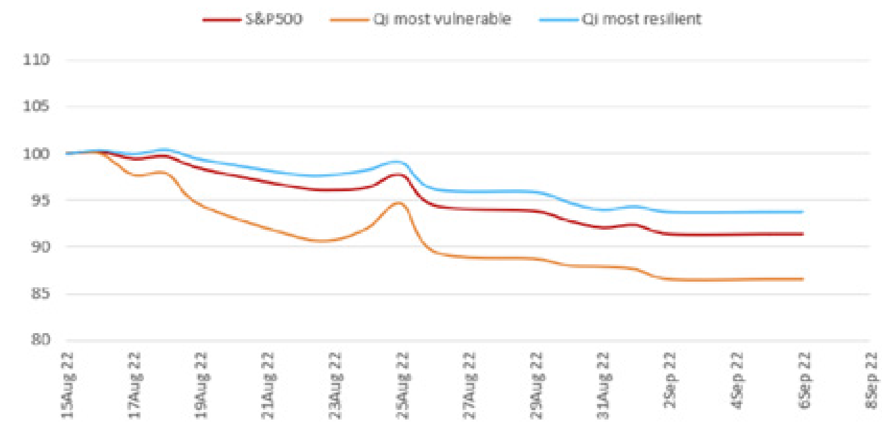
September – How to outperform tighter financial conditions

A real-life case study showing how Qi's macro factor sensitivities can help equity investors tweak their portfolio to avoid macro landmines.
Step one: quantify the fund's key macro exposures – in this instance, US 10y real yields and US High Yield credit spreads.

Step two: identify the 10 stocks most vulnerable to higher yields and wider credit spreads, and the 10 most resilient.

Step three: no need to divest core holdings, tweak the weights according to their macro factor sensitivity.
The result? Qi's choice of resilient stocks outperforms the most vulnerable by 7%, and the S&P500 by 3% over the subsequent 3 weeks.

Original Qi insight - **How to outperform tighter financial conditions**



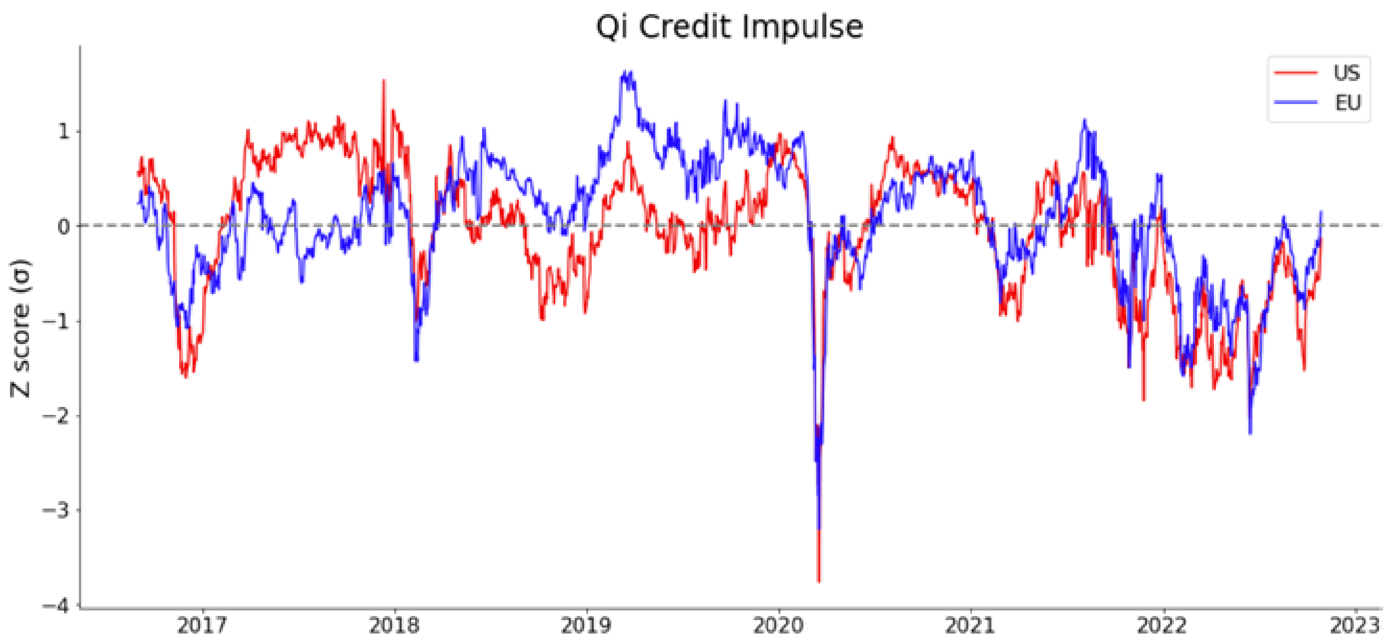
October – Credit Impulse

Stock pickers do not have time to closely monitor shifts in the macro landscape. Qi can be your eyes-and-ears.

Our Credit Impulse aggregates financial conditions into a single measure, capturing when liquidity is being tightened or loosened.

Snapped at the end of October, our Credit Impulse suggested a large amount of the Fed's tightening in 2022 had been unwound.

Original Qi insight - **Dovish pivot? Its already happened**



November – US equities: a shift in factor leadership?

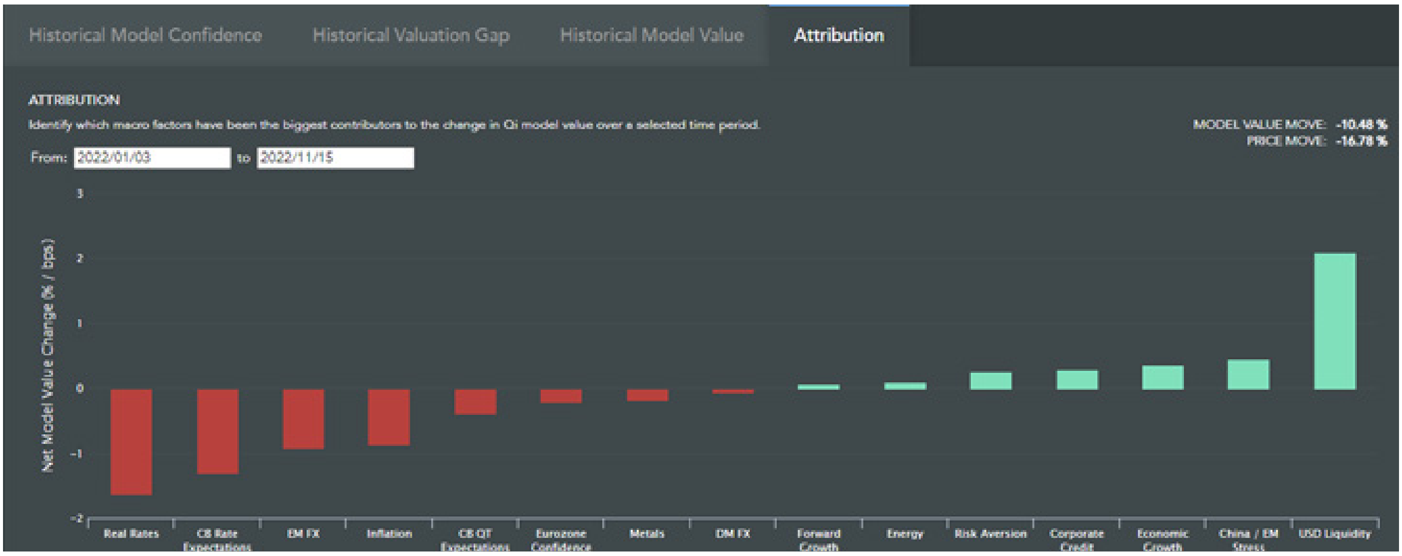
For most of 2022 the message from Qi has been simple – the Fed's tightening of financial conditions is pushing macro conditions against US equity markets.

But over the course of Q4 that pattern started to change and new leadership started to emerge – tentative signs that the real economy could become more important than financial conditions. Presumably a reflection of the market pricing in peak Fed Funds around 5.0%, and now a greater focus on whether 2023 produces a hard or soft landing.

That could imply the reaction function of equities is shifting.

For much of the year, 'bad news' that stays the Fed's hand in raising rates, was deemed 'good news'. A focus on the real economy and fears of a recession could suggest equities will start to recognise bad news = bad news.

Original Qi insight - **US equities – a shift in factor leadership?**



December – a big 2023 reversal?

Qi's model value for USDJPY fx fell 1.5% over November and is down 0.9% so far in December. A pause that refreshes the Dollar bull market, or a critical new trend for the new year?

The strength of the Dollar has been a huge factor for equities in 2022. How is an equity investor supposed to keep an eye on shifts in currency markets?